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Towards a stronger franchise

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Towards a stronger franchise

The management's strategic choice to strengthen brand visibility and increase penetration will create a strong retail franchise and lay the foundation for long term growth fuelled by multi-year demand drivers like increasing urbanization, nuclearisation, housing, electrification and low penetration of many consumer durables. With presence across the complete range of cables up to 400kV and the forward integration into EPC, KEII is poised to grab opportunities across the retail, institutional and EPC segments. We initiate coverage on KEI Industries (KEII) with a BUY rating and TP of Rs381, as we believe higher proportion of retail business, strong balance sheet and RoE of ~23% demand better valuation.

Positioned to exploit long B2C growth runway: Over the years, KEII has emerged as a strong brand in the retail segment, courtesy the management's strategic focus on improving visibility through significant network expansion (the number of dealer/distributors has increased nine-fold since 2011), targeted brand awareness (leading actor as brand ambassador and IPL sponsorship), and performance-linked schemes (dealer trips, electricians factory visits, dealer-electrician meets, gold coin schemes and others). KEII is on track to attain ~40-50% of its sales through retail in the next few years vis-à-vis ~30% at present. 'Housing for All', urbanization and penetration of consumer durables will help the company achieve ~15% growth in the segment in the medium term.

Forward integration through EPC: With strong Institutional capability across the cable segments, KEII has steadily grown its EPC segment through orders from IPDS, DDUJY, substation projects and underground cabling package for various towns. The EPC order book of ~Rs20bn gives strong sales visibility. Further, with its increased capability (will be able to supply up to 400kV cables from FY18) and capacity (900km from 500km few years back), revenue from the EHV segment is expected to rise to ~Rs4bn by FY20 from ~Rs1bn in FY17.

Strong balance sheet to propel further growth: Utilisation levels at ~70% (HH- 50%, Cables-77%, SS-84%) and strong demand imply expansion is a must. With estimated net debt to equity at ~1x for FY18, we believe KEII is well placed for capacity addition without much increase in leverage.

Valuation and Risks: KEII should re-rate further to capture higher retail presence. We have assigned 18x PE (20x to Retail and 18x to Institutional and 15x for EPC) on FY19e EPS of Rs21.1 and arrive at TP of Rs381. Key risks include high commodity price, competition from unorganized players, delay in government schemes like IPDS and DDUJY etc.

Financial Summary

Y/E Dec (Rs mn)	FY15	FY16	FY17	FY18e	FY19e
Net sales	20,310	23,256	26,691	31,881	37,330
EBITDA margin (%)	9.5	10.4	10.3	10.4	10.6
Adjusted net profit	326	622	986	1,290	1,645
Vs. consensus (%)				9.3	11.3
Free Cash flow	1,812	876	(579)	1,757	135
EPS (Rs)	4.2	8.1	12.7	16.6	21.1
growth (%)	180.7	91.0	58.6	30.8	27.5
P/E (x)	72.3	37.9	24.1	18.4	14.4
P/B (x)	7.8	6.4	5.0	4.0	3.2
EV/EBITDA (x)	14.1	11.5	10.9	8.9	7.8
D/E	1.2	1.2	1.4	1.1	1.0
RoE (%)	11.3	18.6	23.5	24.1	24.4
RoCE (%)	15.3	18.7	18.7	17.7	18.5
Dividend yield (%)	0.0	0.2	0.2	0.2	0.3

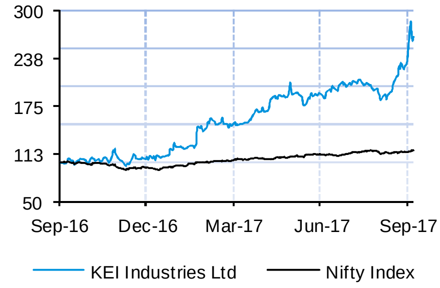
Source: Company, SSLe

Rating	Target Price (Rs)	Upside/Downside (%)
BUY	**381**	**25**

Market data

Current price	**Rs**	**306**
Mkt capitalisation	USDm	371.4
Average daily value 3M	USDm	2.0
Free float	%	48.4
Promoter holding	%	51.6

1 Year Performance



Source: Bloomberg, SSLe

Industry Dynamics

Long Term: House Wire – Long term growth potential , Institutional – Investment related

Medium Term: Steady growth

Company Dynamics

Long Term: Positive – Growth in Retail Sales

Medium Term: EPC and EHV

MOAT

Source: Institutional cables and EHV

Intensity: Medium

Disruption Risk(s)

Nil

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Exhibit 1: Wires and cables market size and key players

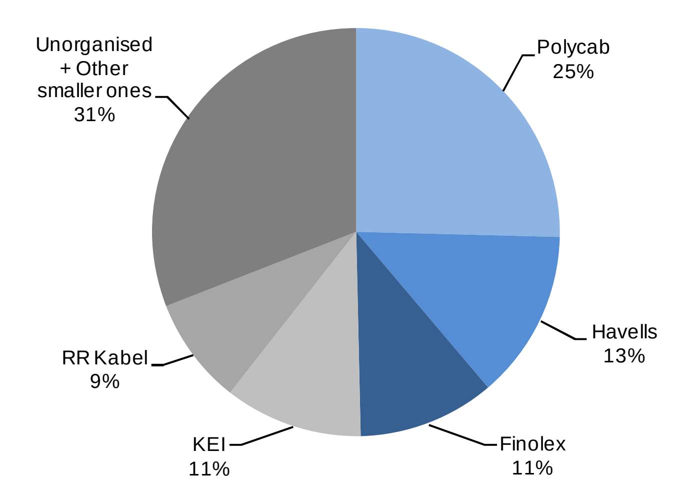
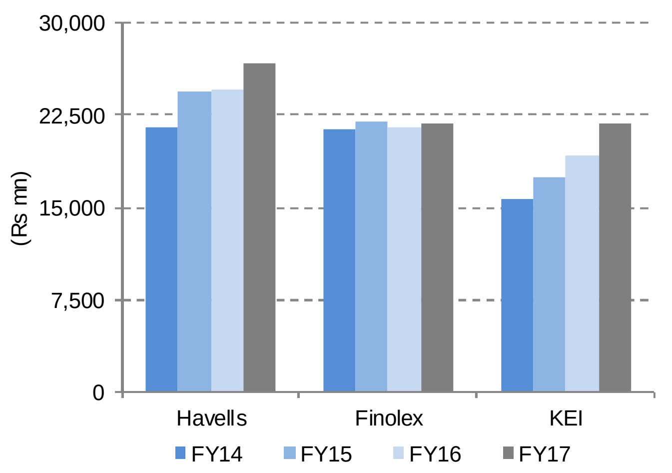


Exhibit 2: CAGR Sales- HAVL(8%), FNXC(1%),KEI(12%)



Source: Industry, SSL

Exhibit 3: Retail sales have mirrored expansion in dealers

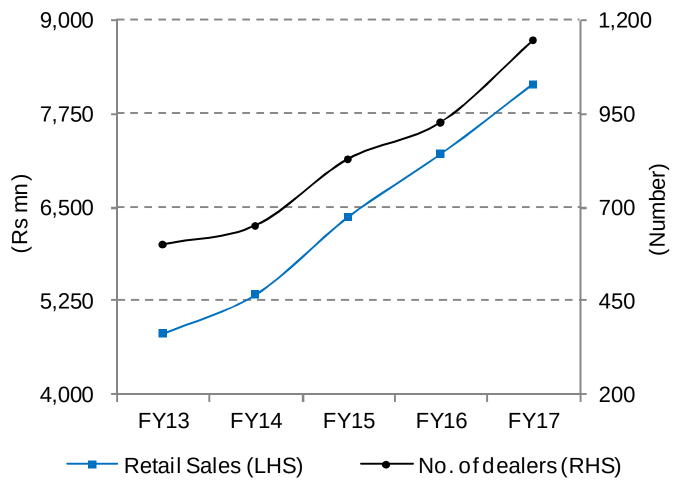
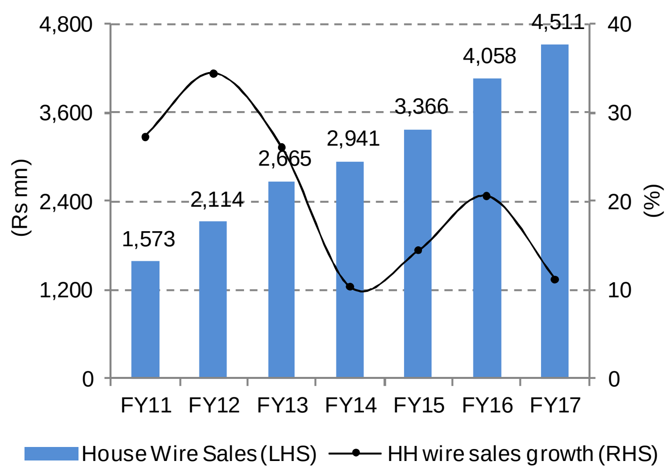


Exhibit 4: House hold wire sales on consistent rise



Source: Company, SSL

Exhibit 5: FY17-19e Sales CAGR of ~18%

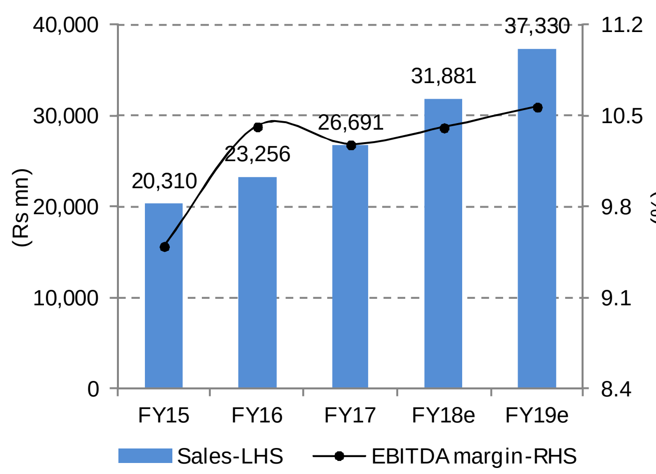
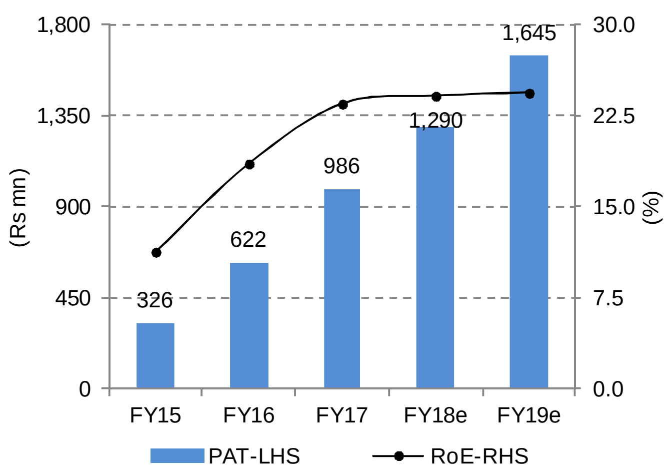


Exhibit 6: FY17-19e PAT CAGR of ~29%



Source: Company, SSL

Positioned to exploit long B2C growth runway

Over the years, KEII has emerged as a strong brand in the retail segment, courtesy the management's strategic focus on improving visibility through significant network expansion (the number of dealer/distributors has increased nine-fold since 2011), targeted brand awareness (leading actor as brand ambassador and IPL sponsorship), and performance-linked schemes (dealer trips, electricians' factory visits, dealer-electrician meets, gold coin schemes and others). KEII is on track to attain ~40-50% of its sales through retail in the next few years vis-à-vis ~30% at present. 'Housing for All', urbanization and penetration of consumer durables will help the company achieve ~15% growth in the segment in the medium term.

Market and key players

The present wires and cables market is worth ~Rs200bn, with domestic wire market at ~Rs80bn and industrial cable market at ~Rs120bn. The domestic wire has been growing at ~10% in the past few years, though industrial cable growth has been low as the capex cycle especially from the private side has been weak.

Exhibit 7: Wires and Cables market size at Rs200bn

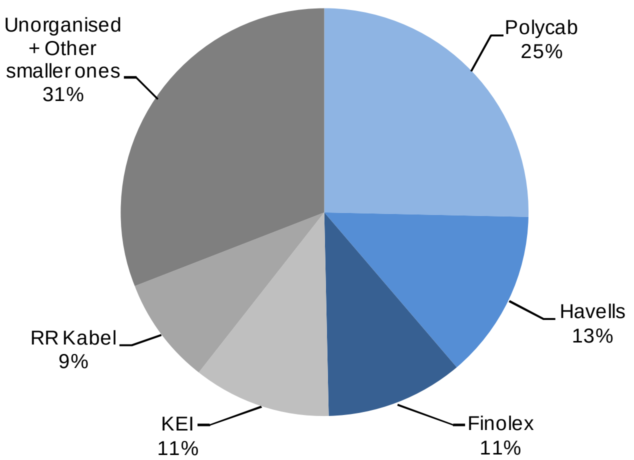
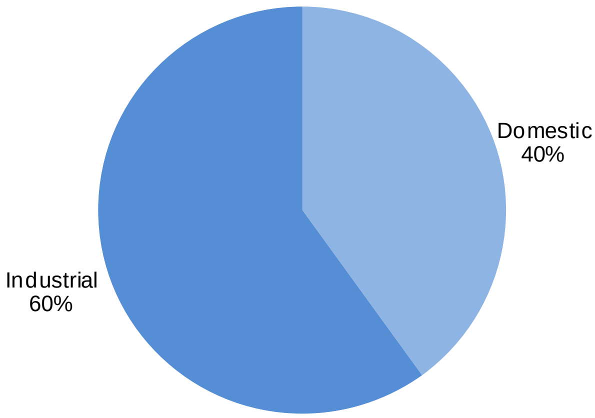


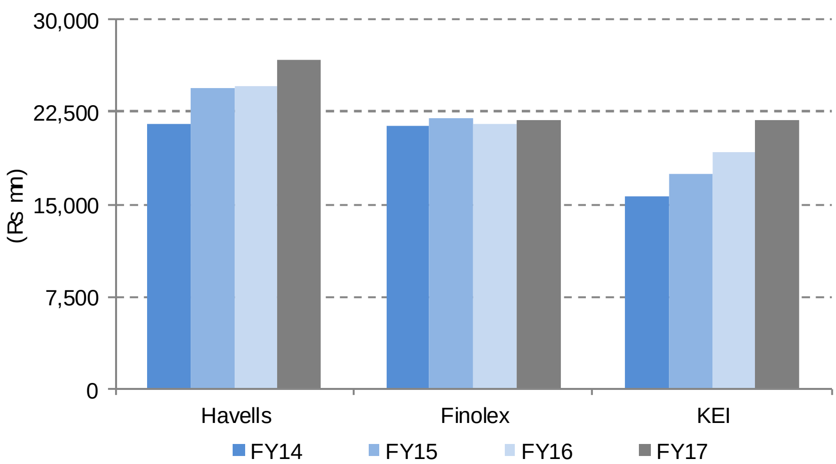
Exhibit 8: Domestic wires at ~40% of overall market



Source: Industry, SSL

Polycab is the market leader in the wires & cables market, followed by Havells, Finolex, KEII and RR Kabel. Among the listed players, KEII (12%) has grown faster than Havells (8%) and Finolex (1%).

Exhibit 9: Wire & Cables sales for Havells, Finolex and KEII



Source: Industry, SSL

During the last 3 years, KEII Sales has grown at CAGR of ~12%, slightly better than players like Havells (8%) and significantly better than Finolex (1%)

Growth drivers – huge opportunity awaits

The overall consumer durables market along with house wires is expected to grow in the 11-12% range over the medium term as per various projections. Urbanisation, electrification, nuclearisation, low penetration levels of various products and impetus to housing (including government schemes) are key drivers of demand for the house wires.

Urbanisation levels in India on rise

Urbanisation and nuclearisation have been a trend for the last several decades and these have boosted growth for multiple sectors, including consumer products. A look at the average annual growth rates across decades reveal India's growth is still accelerating compared to some of the other economies.

Exhibit 10: Urbanization is on steady rise in India

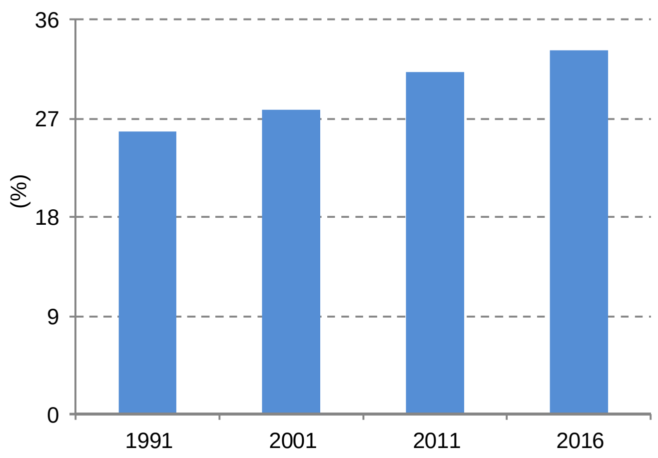
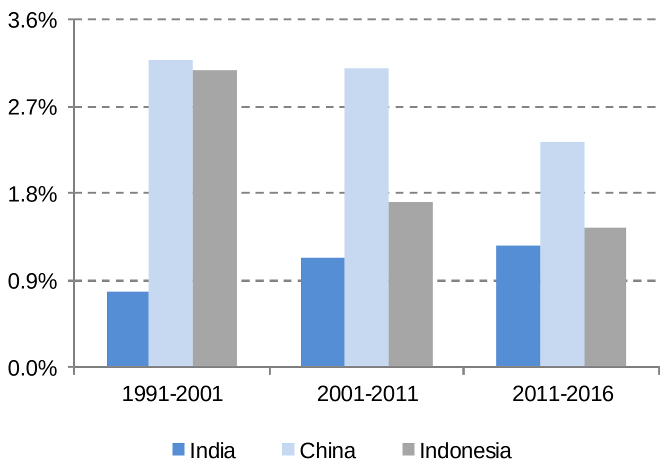


Exhibit 11: Indian urbanization rate on rise



Source: Industry, SSL

Electrification a key demand driver

Exhibit 12: Village electrification at ~99.25%

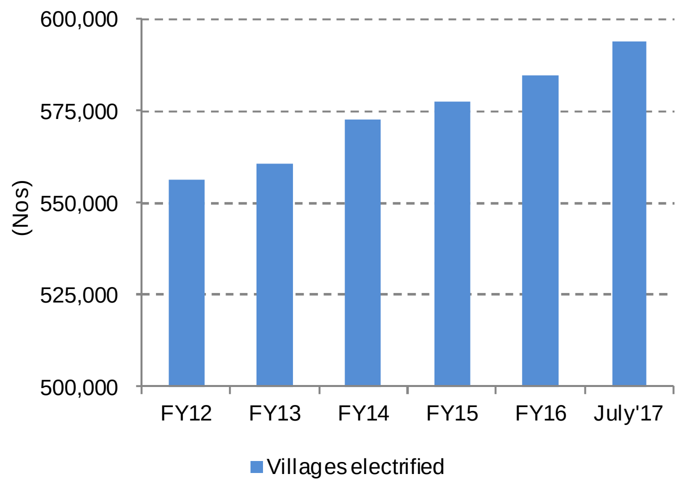
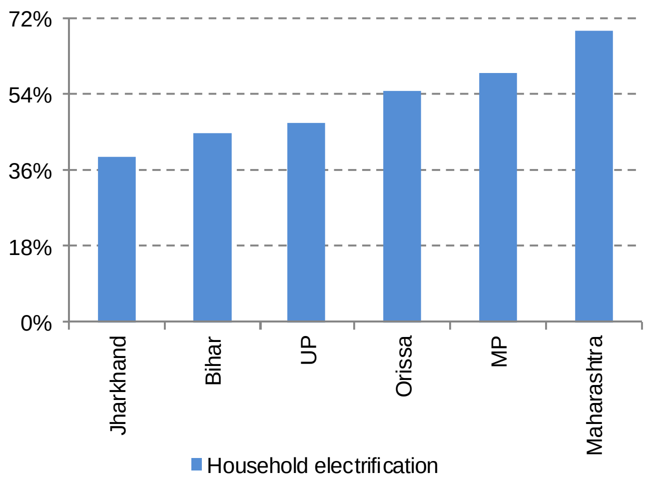


Exhibit 13: Household electrification still at ~75%



Source: GoI, SSL

There has been good pace in village electrification levels in the country and ~99.25% of the villages have been electrified as per the latest data. While village electrification levels are high, household electrification (HH) electrification still stands at ~75%. HH electrification in Jharkhand/Bihar/UP/Orissa/MP/Maharashtra is still below 70% levels, and hence there is huge scope for all electrical goods including wires.

We believe electrification is only the initial demand driver. Once electrification happens, usage of consumer durables increases, which eventually leads to higher wire usages as well. Higher availability of power typically leads to more usage of electrical products. Given the strong growth prospects of consumer durables, the usage of wires per household will increase further.

Exhibit 14: Rise in electrification and TV usage

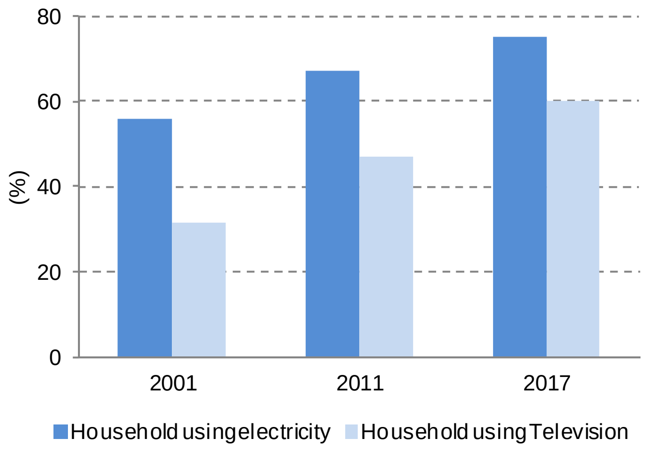
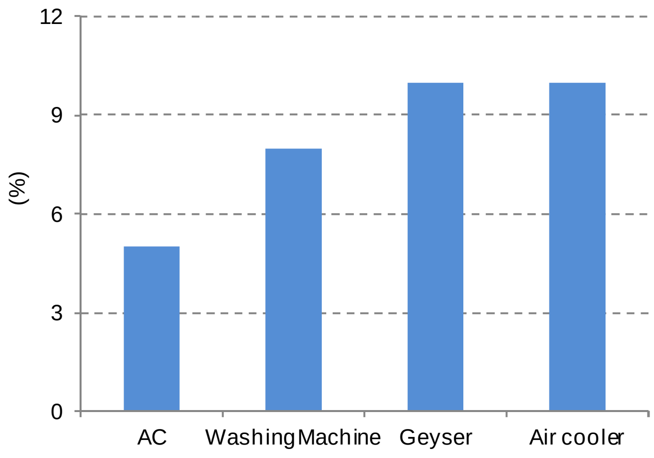


Exhibit 15: Abysmally low penetration of several appliances



Source: Industry, SSL

Housing to spur demand

During the period 1991-2011, annual growth in household addition stood at ~2.5-3%. The CAGR for concrete roof houses stood in the 7-9% range. On an average annually 5.5mn houses/3.4mm concrete roof houses were added in the decade 2001-2011. Given the increased rate of urbanisation and the government's focus on Housing for All, it is estimated that 7-8mn houses will be added annually in the medium term.

During 2001-2011, ~30mn rural houses and ~25mn urban houses were added. The government's "Housing for All" scheme aims to add 50mn houses by 2020 (Urban - 20mn; Rural - 30mn). This would increase the number of houses being built in the medium term. Given the increased affordability (rising income) we believe the number of rooms per house would increase over the longer term from current levels. Case in point: number of houses with one room decreased from 39% in 2001 to 37% by 2011. Our discussions with several architects and electricians suggest that homes with conceal wiring need 25-50% more wire. We believe an increase in affordability would eventually lead to higher per capita consumption.

Exhibit 16: Houses (mn) added during 2001-2011

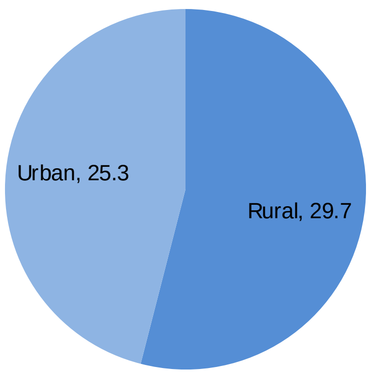
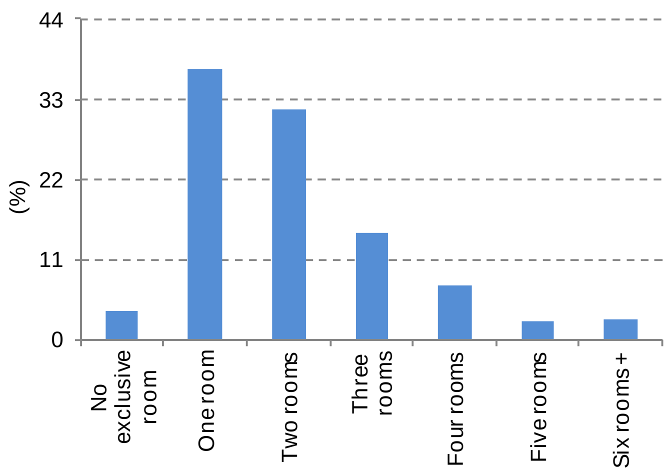


Exhibit 17: Affordability to increase the rooms per houses



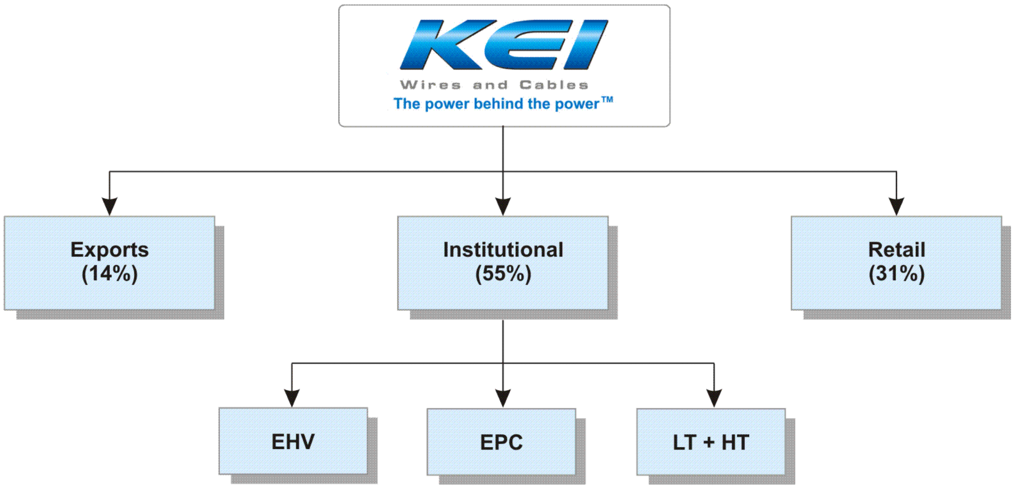
Source: GoI, SSL

All the above factors clearly imply that the sector is likely to see 10-15% growth in medium term; companies with better strategy, lower reach and focus on household segment will be able to grow above 15%.

KEI's retail strategy- multi-year growth

KEII has structured its business into retail, exports and institutional segments. Currently, retail accounts for ~31% of the overall sales. Retail refers to household wire and LT power cables sold through dealers. Household wires account for ~16% of the sales, and have grown at 16%/25% CAGR in the last 5/10years compared to ~10% for the industry.

Exhibit 18: Retail sales more than 30%



Source: Company, SSL

In the last 4-5 years, Polycab, Havells and KEII have gained market share in the house wire segment through aggressive sales and marketing. Retail commands higher margins (~12-13%) vs. power cables. House wire's proportion in overall wires and cables for Polycab (40%), Finolex (60-65%), Havells (48-50%) is still far higher as compared to KEII (20%); hence, we believe growth can continue.

KEII has been able to increase its market share in the last few years, courtesy its strong retail sales. While the overall market share in wires & cables stands at ~11%, the share in domestic wire is still low at ~6%. KEII has increased the market share in the domestic wire segment by ~300bps in the last 5-6 years.

As can be seen from the charts below, house wires have had a consistent growth trajectory.

Exhibit 19: Sales CAGR (5yr) in LT+HT cables at ~5%

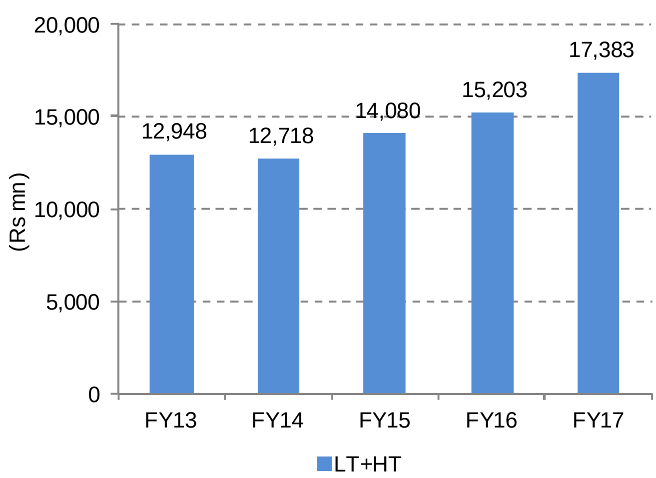
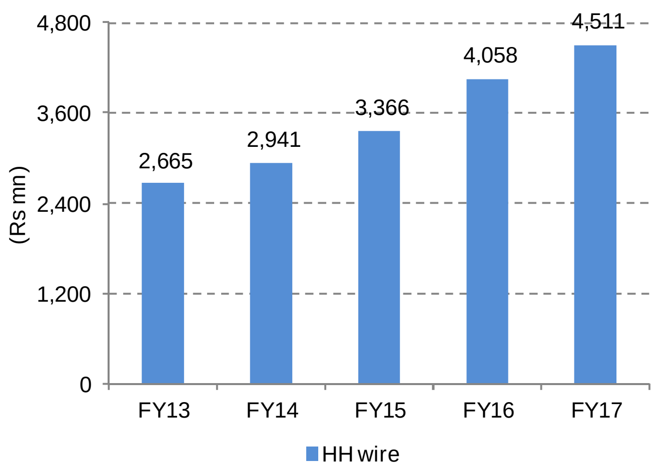


Exhibit 20: Sales CAGR (5yr) in House wire at 16%

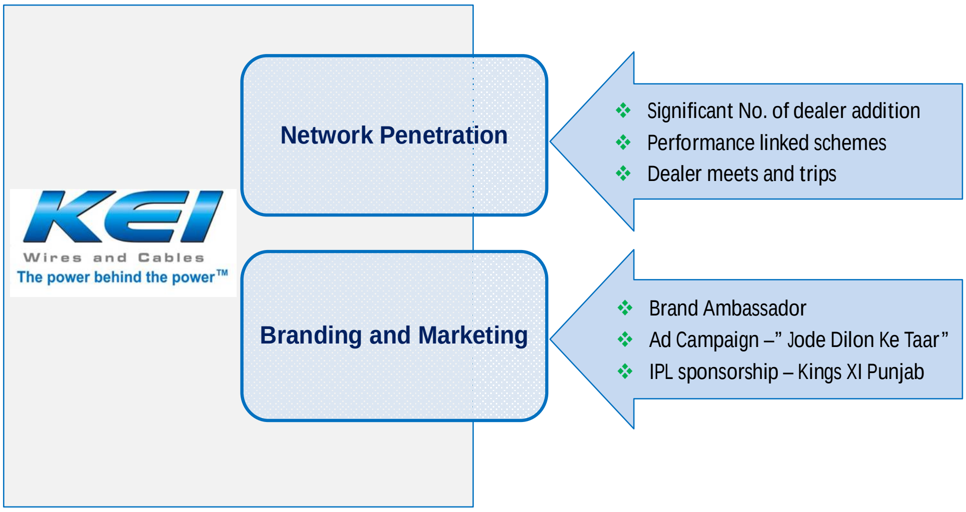


Source: Company, SSL

The retail or B2C segment is driven by more brand awareness, distribution network, product offerings and quality of the product.

KEII's two-pronged strategy to strengthen its presence in the retail segment has worked really well. The company has been continuously expanding its dealer network at one end and has aptly aligned its aggressive branding and marketing campaign with it. Both these have had direct co-relation with the company's retail sales, which have grown by 12-15% in the last 6-7 years.

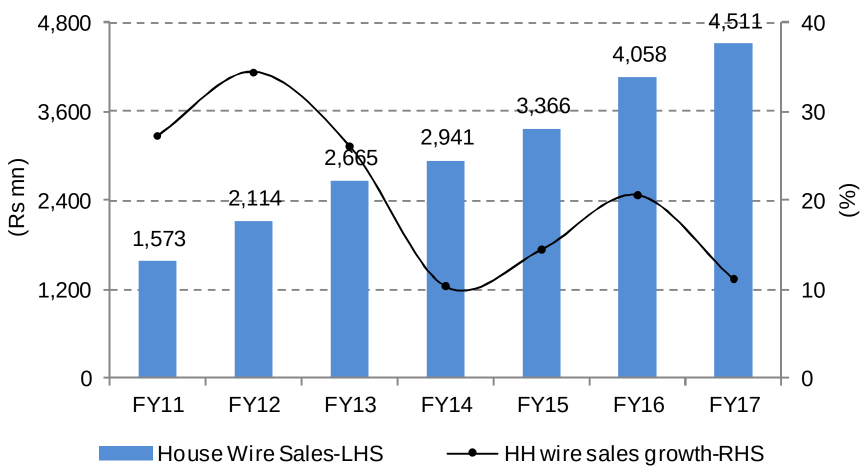
Exhibit 21: Building a stronger franchise



Source: Company, SSL

Sales in the household wires segment have been on a consistent uptrend and this has helped the company garner ~6% market share in this segment. The market share has been rising continuously in the past few years. During the last 5/7/10years, sales of household wire have increased at a CAGR of 16/20/25%.

Exhibit 22: House wire segment has grown at 25% CAGR over last 10 years

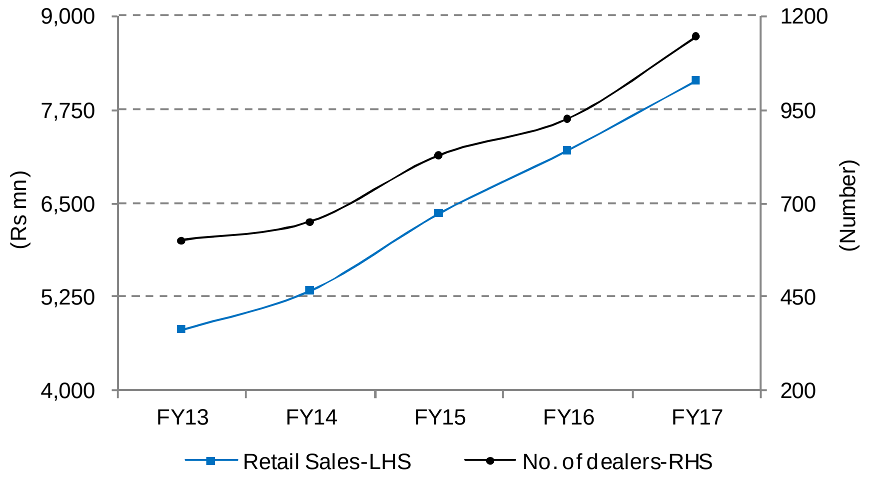


Source: Company, SSL

5yr/7yr/10yr CAGR for House wire sales stands at 16%/20%/25% respectively

As part of network expansion, KEII has added ~500 dealers in the last 3 years and had ~1150 dealers/distributors at the end of FY17. Given its low base, over the last 7-8 years, the number of dealers/distributors has seen a nine–fold rise. This has enabled the company to be present across the country than being region-specific. Given the target to increase the proportion of sales from ~31% to 45-50% over the next few years, KEII intends to continue this pace of network expansion in the coming years as well. During 1QFY18, 99 new dealers have been added.

Exhibit 23: Retail sales have mirrored expansion in dealer network



Source: Company, SSL

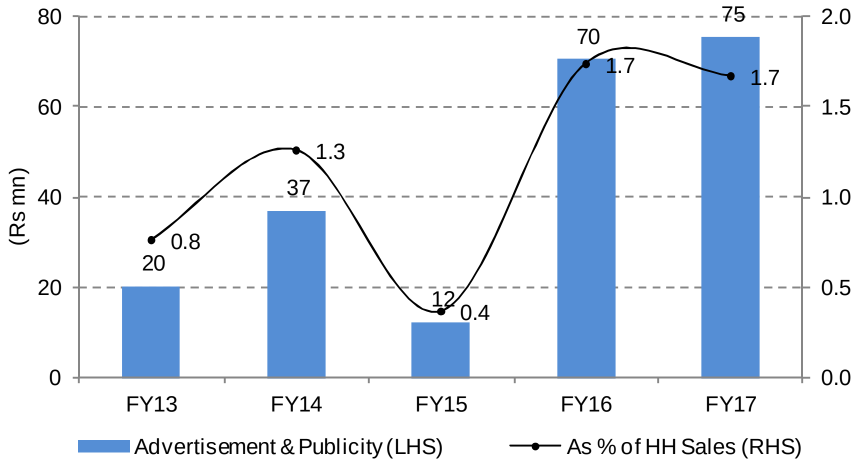
Over the last 7/8 years, KEI has increased the no. of dealer/distributor by 9 fold and has ~1150 dealers presently

During 1QFY18, KEII has added 99 more dealers, taking the overall number of dealers to 1246

KEI has had a clear focus on building a strong brand in the retail segment. This is also evident from the various marketing strategies and expenses incurred on advertisement and publicity.

In the last few years, KEI's advertisement and publicity expense has been rising. In absolute terms, it has increased from Rs20mn in FY13 to ~Rs75mn in FY17. As a percentage of overall house wire sales, it stands at ~1.5%. Given KEI is still smaller as compared to Polycab, Havells and Finolex in this segment, we believe it will need to continue ramping up its expense in the coming years for better visibility and brand enhancement.

Exhibit 24: Advertisement as % of Sales on rise

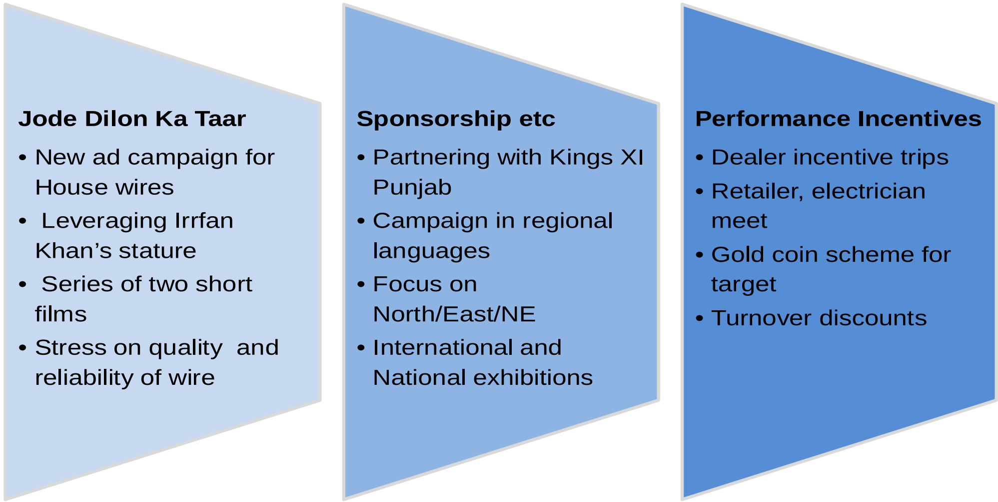


Source: Company, SSL

We believe, KEI has off-late increased the advertisement and publicity spent. This coupled with various initiatives will lead to a strong growth in the retail sales in the medium term

KEI's latest advertisements, sponsorship related spends and incentives with relation to performance will lead to continued growth in its retail segment. We believe continued efforts towards creating a brand will lay the foundation for long term growth for the company.

Exhibit 25: Sales and Marketing activities by KEII



Source: Company, SSLe

KEI’s latest advertisement campaign, ***“Jode Dilon ka Taar”,*** for house wires, leverages the stature of Irrfan Khan through a series of two short films that stress on the quality of wires.

Lead Arm Sponsorship: KEI has partnered with Kings XI Punjab in IPL; this has significantly increased the brand visibility.

Campaigning in regional languages: Its cable TV campaign in states such as Assam, Bihar, Jharkhand, Manipur and Orissa is aimed at strengthening its presence in the Eastern/North Eastern regions.

At the dealer level, performance-linked schemes like dealer incentive trips, electrician factory visits, meet among dealer/distributor and electricians, gold coin scheme for target achievement were employed.

Institutional sales - Forward integration through EPC

With strong Institutional capability across the cable segments, KEII has steadily grown its EPC segment through orders from IPDS, DDUJY, substation projects and underground cabling package for various towns. The EPC order book of ~Rs20bn gives strong sales visibility. Further, with its increased capability (will be able to supply up to 400kV cables from FY18) and capacity (900km from 500km few years back), KEII's revenue from the EHV segment's is expected to rise to ~Rs4bn by FY20 from ~Rs1bn in FY17.

Strong capability helped attain high market share

KEI has the capability of making cables up to 400kV. Apart from house wire, LT, HT and EHV cables, it makes control and instrumentation cables, specialty cables, rubber cables, submersible cables; poly wrapped winding wires and stainless steel wires.

Key offerings under EPC:

- Power Transmission projects of 6kV to 400kV
- EPC of cable system
- Electrical BoP
- Electrical industrial projects

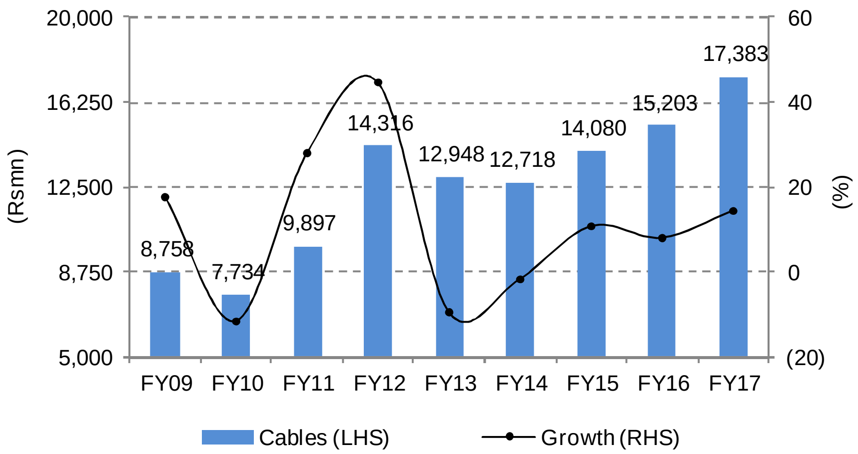
With factories in the North and West and a wide product range, KEI has been able to tap a number of top clients. It has been associated with a number of top companies across diverse sectors such as power, industrial, refinery, energy, fertilizer and steel sectors. The company is also building specialised offerings to tap opportunities in the solar and shipping sectors.

The above capabilities and manufacturing facilities has helped KEI achieve ~15% market share in the ~Rs120bn market. Growth in the institutional market has been muted across the industry as private capex has been subdued. The government's focus programs like Power for All, IPDS and DDUGJY along with spends on transmission & distribution, infrastructure, renewable and transportation are the main drivers.

Cable (excluding House wire) sales CAGR has stood at 4%/13% over the last 5/10years. There is a bit of cyclicality in the sales on account of end use sectors like power and infrastructure.

Since FY14, sales growth has been steady, which is expected to be maintained with higher EHV/EPC sales.

Exhibit 26: Cables excluding house wires sales CAGR at 4%/13% over last 5/10 years

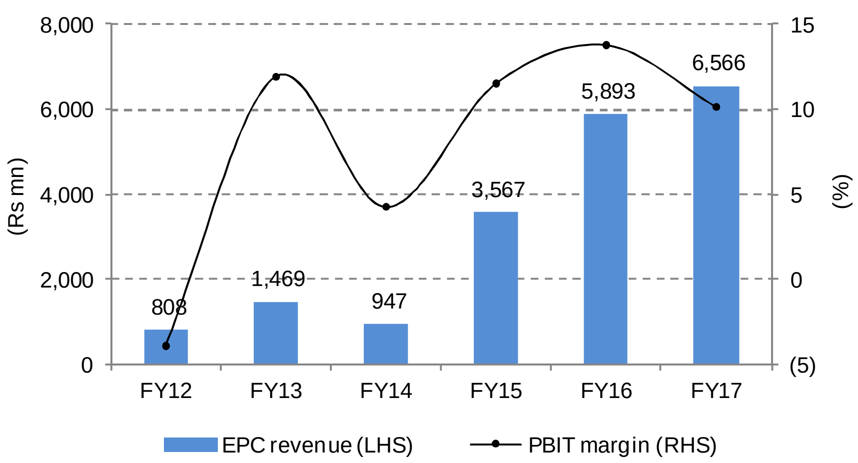


Source: Company, SSL

EPC- strong order book to fuel medium term growth

KEII's strategy to enter EPC (started in FY10) as a forward integration would help it grow faster (as new revenue stream) with effective use of present cable capacity (cable accounts for ~30% in EPC done by KEII).

Exhibit 27: EPC to add to overall growth in medium term



Source: Company, SSL

Of the Rs6.5bn EPC revenue, ~Rs1.8bn was on account of cables.

We expect EPC sales to reach ~Rs10bn by FY19.

Sales in the EPC segment have increased steadily over the years through orders from IPDS, DDUGJY, substation projects and underground cabling package for various towns, and are expected to reach ~Rs10bn in FY19. Importantly, cables account for ~25-30% of EPC contracts, which is in house. As the company has attained a certain level of revenue in the EPC segment (since FY15), PBIT margin has been in the ~10-12% range.

The EPC order book of ~Rs20bn gives strong sales visibility. Further, with its increased capability (will be able to supply up to 400KV cables from FY18) and capacity (900km from 500km few years back) in the EHV segment, it is expected to clock ~Rs4bn revenue by FY19 in this segment vis-à-vis ~Rs1bn currently.

Exhibit 28: 3 year CAGR in order book at 32%

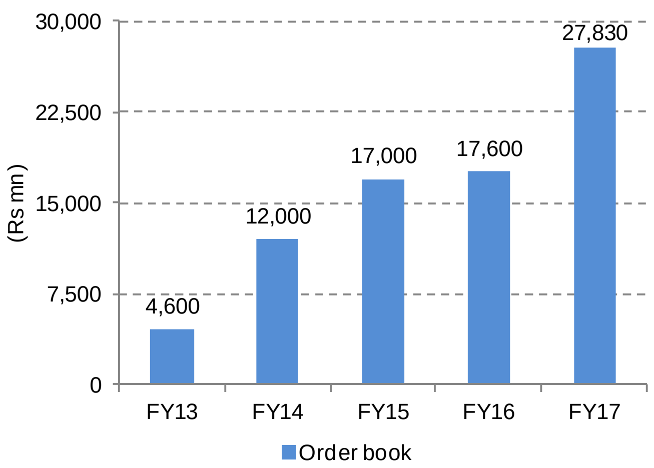
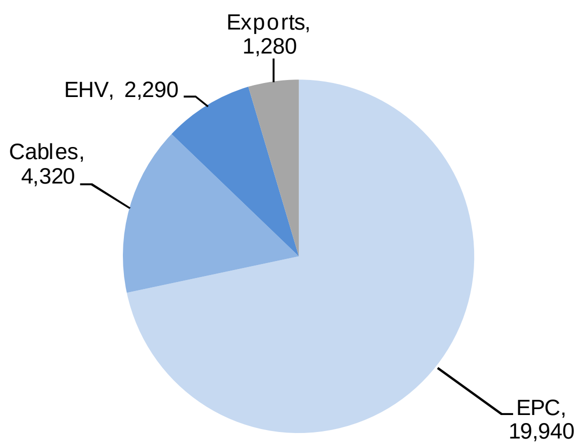


Exhibit 29: EPC book (Rs mn) to ensure strong growth



Source: Company, SSL

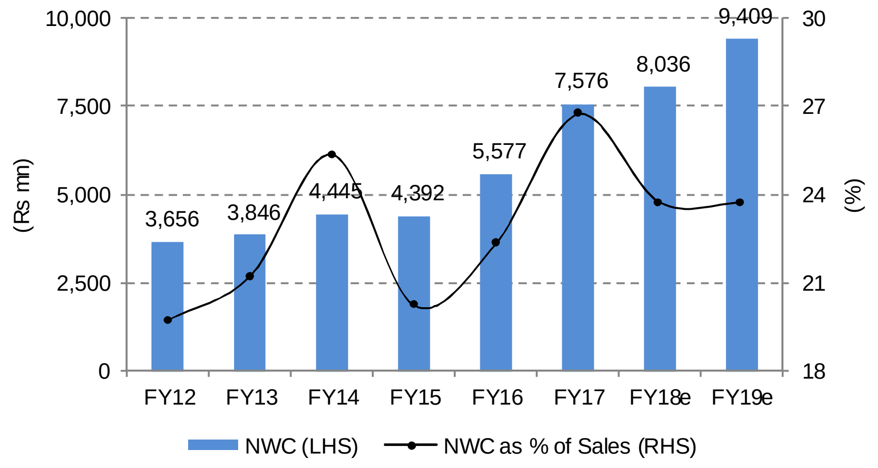
One of the key aspects in any EPC business is the management of working capital, as typically, the payment cycle for states is not very predictable. We have studied how the New Working Capital (NWC) has moved for the company in the last 5 years.

FY12-FY15: During this period, NWC remained in the Rs3.5-4.5bn range, and accounted for ~21% of sales.

FY15-FY17: EPC revenue ramped up from Rs3.5bn to Rs6.5bn, leading to an increased need for working capital. During FY17, NWC stood at ~27% of sales, as debtors increased by ~30% for 15% sales growth. This was largely on account of an increase in retention money.

We estimate NWC as % of sales to come down to ~23.5% from ~27% in FY17

Exhibit 30: NWC as % of sales expected to come down



Source: Company, SSLe

While the company has a strong EPC order book, which will lead to sales growth in FY18 and FY19, KEII doesn't want to ramp up this business very fast hereon. The two key aspects related to this are:

- There has been a ramp up in terms of manpower in this segment and the company wants to first execute some of the large orders in hand before seeking even bigger orders. This will help the team build up capabilities, which can be scaled up later.
- As working capital needs are higher in the EPC business, they want to have sales level of Rs10bn in the near term, so that incremental need for working capital is limited. Once they are able to get retention money from executed projects, the company can look for more large projects.

Further, orders from the state of UP form ~70% of the total order book. The company intends to have higher geographical diversification in the coming years, and it is targeting WB, Rajasthan and MP for orders. KEII expects to win orders worth Rs5-6bn in the current fiscal.

EHV- ramp up in the next few years

The EHV market is India is estimated to be worth ~Rs20-25bn; the share of imports stands at 25-35% as per the industry. The overall margin levels in the EHV segment are higher (estimated ~15%) as compared to other cables. Given the stringent norms and validation from international agencies, only a few players like KEI, Universal and KEC have built in capability for this market. Also, due to the high entry barriers, there are just a handful of players in the segment.

KEI forayed into manufacturing of EHV cables up to 220kV in FY10, in collaboration with Brugg Kabel, AG. This helped the company meet demand from mega power plants, transmission companies, cities needing underground cabling, large realty project, IT Parks, residential townships, metro rail projects etc.

In 4QFY17, KEI started its new 400kV (EHV) line at its Chopanki plant, which will help the company become one of the top three players supplying cable of these voltages. KEI now has installed capacity of 900km and can clock overall revenue of ~Rs4bn. The company's FY17 revenues, at ~Rs1bn, were impacted by the shutdown for 4-5 months for expansion. At present, the company has orders worth ~Rs2.3bn in the EHV cable segment, including accessories. Some of the key projects executed during the last few years include:

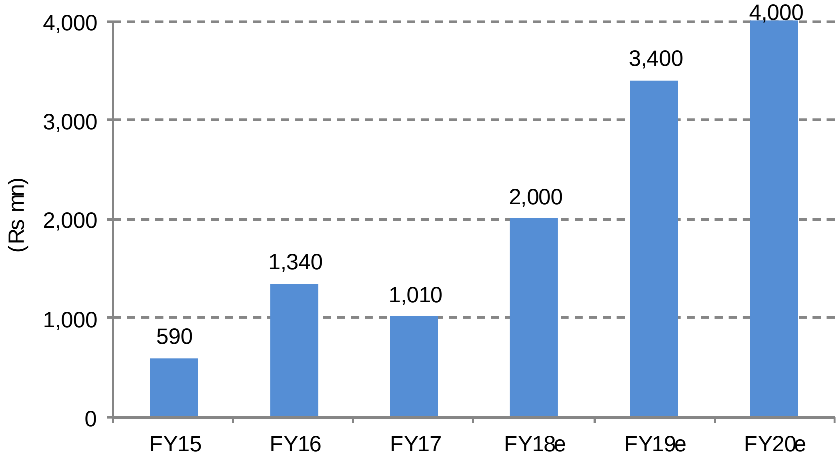
Exhibit 31: Key orders in EPC and EHV

Key project executed in EPC	Key Orders executed in EHV Segment
❖ EPC of HV Cablings system for JVVNL, Jaipur	❖ Executed order of KPTCL worth Rs75 Crores
❖ MES for 100kV Transform and Electrical System of Air Force station, Gurgaon	❖ Executed order of Rs.138 crore of Uttar Pradesh Rajkiya nirman Nigam Ltd.
❖ Projects for power transmission utilities including projects for MSETCL, KSEB, TNEB, RVPNL	❖ Executed 220 KV EHV Project of Rs. 65 Crore of DMRC
❖ Projects for Reliance Infrastructure (400kV switchyard for 2x600 mw Thermal Power Project at Hissar	❖ Executed 220 KV EHV Project of Rs. 40 Crore of PGICL
❖ Industrial sector for AERENR, Ludhiana	
❖ Private utilities like Reliance, Tata Etc	
❖ RAPDRP/DDUGY Project at Mathura , Vrindavan	

Source: Company, SSL

Given the strong demand and high import of EHV cables in the country, we expect revenues in this segment to touch ~Rs4bn by FY20.

Exhibit 32: EHV sales to scale up with approval for 400kV



Source: Company, SSLe

EHV sales in FY17 was impacted by 5 month shut down in the plant for expansion of capacity

Installed capacity now stands at 900km vs 500km earlier

EHV order book at the end of FY17 stood at Rs2.3bn

Switzerland-based M/s Brugg Kabel AG. Brugg has over 100 years of experience and the ability to manufacture cables up to 550 kV. This collaboration has given KEI a faster entry into the EHV cable market, with designs, process back-up – services that are sought by end users.

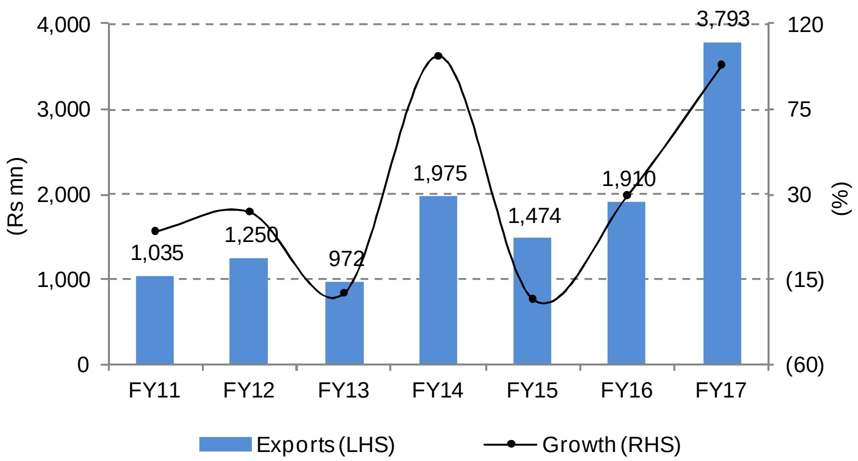
Apart from technological collaborations, KEI has backward integration through in-house PVC compound manufacturing, which helps in maintaining the quality standards in these contracts

The demand for EHV cables generally arises from transmission companies in the country. It is also used in several sectors such as steel, refineries, IT parks, cement, metro, power etc. During 1QFY18, revenues from the EHV segment stood at Rs590mn – almost 60% of FY17 sales. The Chopanki plant's utilisation for EHV stood at ~35% during the quarter, but it is expected to improve to ~50% by the year end.

Exports to remain steady

Exports formed ~14% of the overall revenues in FY17 for KEI, which has presence in over 45 countries the globe. The key focus areas in the exports market are the oil & gas and utilities segments. KEI's overseas product basket consists of EHV (66kV to 220kV), MV (6.6kV to 33kV) and LV (<6.6kV).

Exhibit 33: Exports had a strong FY17



Source: Company, SSL

While the Middle East has traditionally been a key focus area, the company has diversified into various other geographies such as Singapore, Australia and Africa. It has offices in Singapore, Nigeria and Dubai, while it operates through agents in Korea and Australia. During FY17, KEI strengthened prequalification parameters in various geographies.

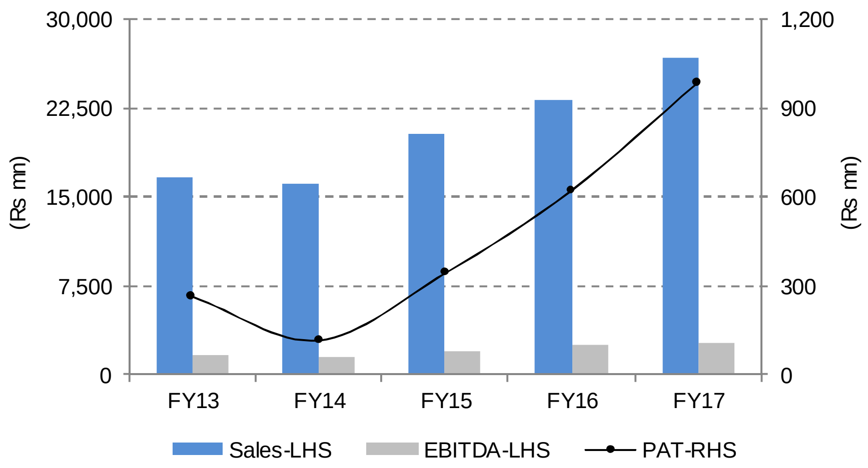
Exports fell in FY15 due to a delay in the execution of certain contracts, especially in the Middle East region, due to volatility in crude oil. Since then, there has been a strong uptick in sales.

Strong balance sheet to propel further growth

In the past 5 years, the company's Sales/EBITDA/PAT CAGR stood at 9%/13%/32%. Utilization levels for Household wires (~50%), Cables (~77%) and Stainless Steel (~84%) are clearly on an uptrend. The demand scenario has been strong, which means KEII would need to expand to maintain the growth levels. With estimated net debt to equity at ~1x for FY18, we believe KEII is well placed for capacity addition without much increase in leverage.

In the past 5 years, Sales/EBITDA/PAT CAGR stood at 9%/13%/32%. While the EBITDA margin rose ~100bps, the key improvement has been the fall in interest cost as percentage of sales; it dropped to ~4.3% from 6.4% in FY14.

Exhibit 34: Strong earnings growth in the last 5 years



Source: Company, SSL

Exhibit 35: Finance cost under control

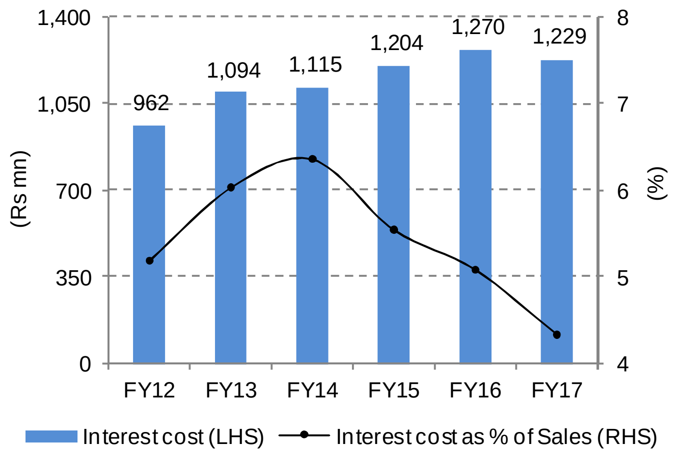
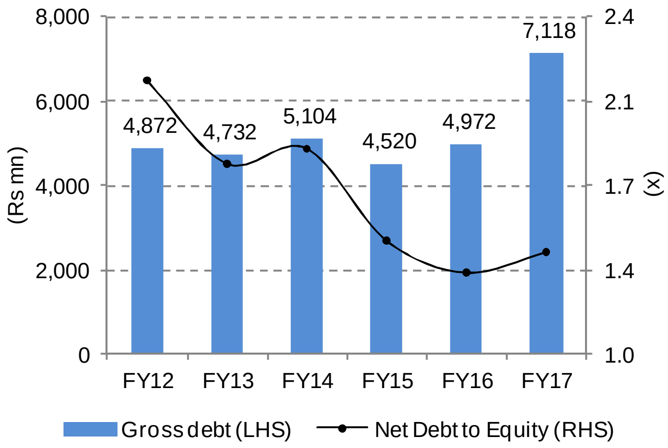


Exhibit 36: Debt increase in FY17 on higher EPC revenue

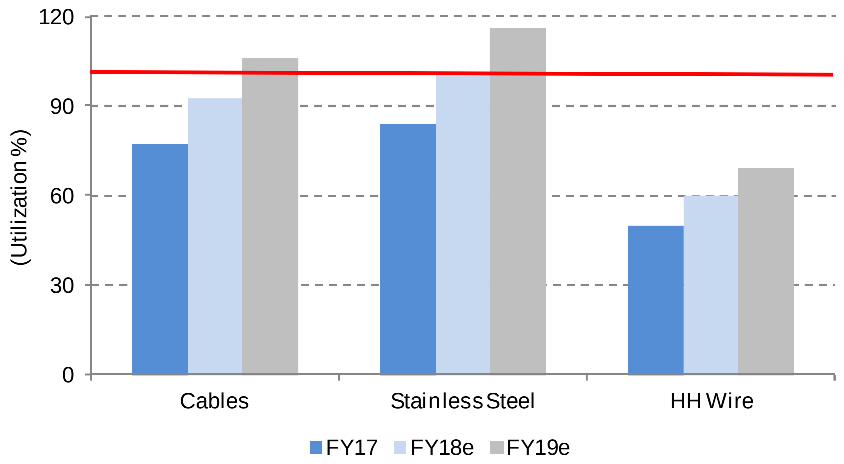


Source: Company, SSL

Expansion a must: Given the strong demand, we believe KEII will need to expand its capacity if it has to maintain its growth trajectory in the 15-20% range. The capacity utilization levels of Cables/Stainless steel/HH wire stood at 77%/84%/50% in FY17.

Capacity utilization levels of Cables / Stainless steel/ HH wire stood at 77%/84%/50% in FY17

Exhibit 37: Capacity utilization to peak out in mid FY19 for Cables and SS



Source: Company, SSLe

Capex plan: Near and Medium term

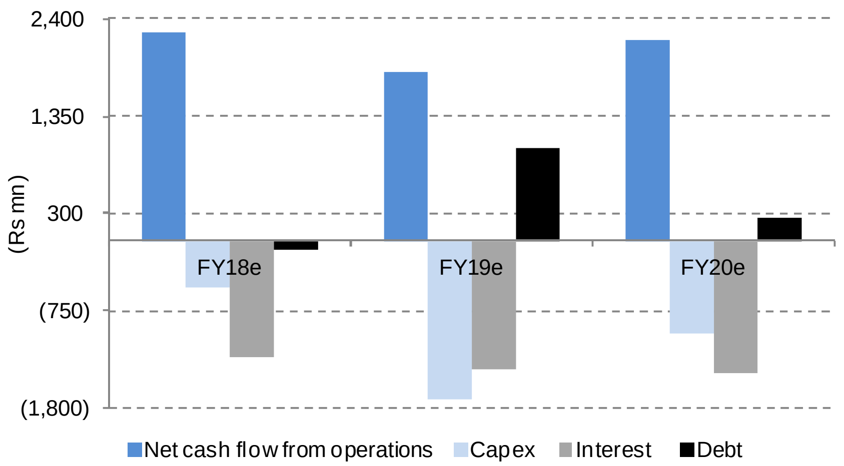
By the end of FY18, the management intends to invest Rs500mn for capacity expansion; this will enable it to maintain the 15-20% growth target in FY18 and FY19. This Rs500mn will ensure revenue visibility of ~Rs3bn from this facility.

Beyond this, KEI intends to go for a greenfield capex of ~Rs2.25-2.5bn in FY19 and FY20, which will create capacity for further growth. Our analysis suggests this greenfield capex will be sufficient to provide ~10% growth for 3 years (FY20e-FY22e), considering demand growth continues to be at moderate levels.

We estimate capex in excess of Rs3bn over the next 3 years.

While the Rs500mn capex in FY18 would be funded through internal accrual, we believe the greenfield capex of Rs2.5bn will mean debt raise of Rs1bn.

Exhibit 38: Capex of Rs3bn in next 3 years, we estimate Rs1.2bn of debt raise



Source: Company, SSLe

Exhibit 39: Key assumptions for sales from various segments and other P&L elements

Revenue (Rs mn)	FY17	FY18e	FY19e	FY20e	Remarks
HT Power cables	3,800	4,200	4,620	5,082	Moderate growth
Growth (%)		10.5	10.0	10.0	
LT Power Cables	12,320	13,552	15,246	17,152	Growth to pick up
Growth (%)		10.0	12.5	12.5	
EHV	1,010	2,000	3,400	4,000	Ramp up on account of capacity increase
Growth (%)		98.0	70.0	17.6	
HWWW	4,280	4,922	5,660	6,509	Strong growth to continue
Growth (%)		15.0	15.0	15.0	
SS Wire	1,040	1,040	1,040	1,040	Not much capacity left
Growth (%)		0.0	0.0	0.0	
EPC	4,240	6,167	7,363	8,500	EPC increase based on Order book
Growth (%)		45.4	19.4	15.4	
Total	**26,690**	**31,881**	**37,329**	**42,283**	16.5% CAGR over FY17-FY20e
Growth (%)		***19.4***	***17.1***	***13.3***	
EBITDA	2,743	3,318	3,945	4,619	Capex of ~Rs3bn over next 2 years
EBITDA margin	10.3	10.4	10.6	10.9	
Depreciation	280	292	309	372	Increase due to new units
Interest	1,229	1,263	1,387	1,430	Higher debt, though interest cost still under control
Tax rate (%)	26.3	30.0	30.0	30.0	
PAT (Rs mn)	986	1,290	1,645	2,042	
EPS (Rs)	12.7	16.6	21.1	26.2	27% CAGR over FY17-FY20e
Growth (%)		30.8	27.5	24.2	

Source: Company, SSLe

Our analysis suggests that Sales/PAT CAGR during FY17-FY20e would be 16.5%/27%.

Consistent margin, controlled WC, and hence, improving RoE

Two of the segments, HH and EHV, that are expected to drive sales in the coming years, command 12%/15% EBITDA margin and hence we believe some uptick in margin is likely. Debt levels have increased in FY17 on account of increased revenue in the EPC segment. Based on the current order book, EPC revenue is expected to touch ~Rs8.5bn in FY18 (including cables), which would imply a marginal increase in working capital levels, though debt levels should not increase materially due to strong cash generation.

Exhibit 40: Gross and EBITDA margin

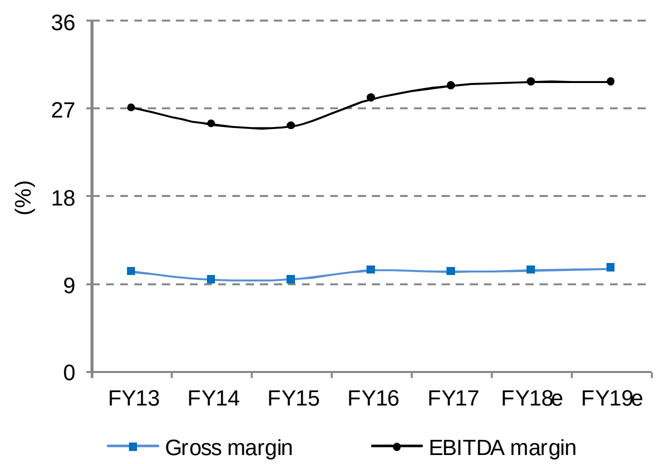
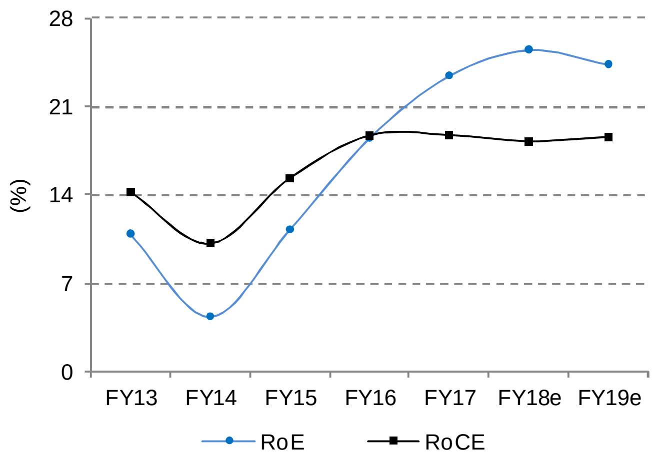


Exhibit 41: Return ratios superior



Source: Company, SSLe

Business structure and Manufacturing facilities

KEII has structured its business into three segments, namely, retail, Institutional and exports. Sales of HH wire along with cables sold through dealers are categorised under Retail. Institutional caters to the need of various sectors like transmission, energy, metros, railways, infrastructure and refineries among others. EHV and EPC form part of Institutional segments. Within exports, KEII sells LV, MV and EHV cables.

Exhibit 42: Sales of Institutional/Retail over years

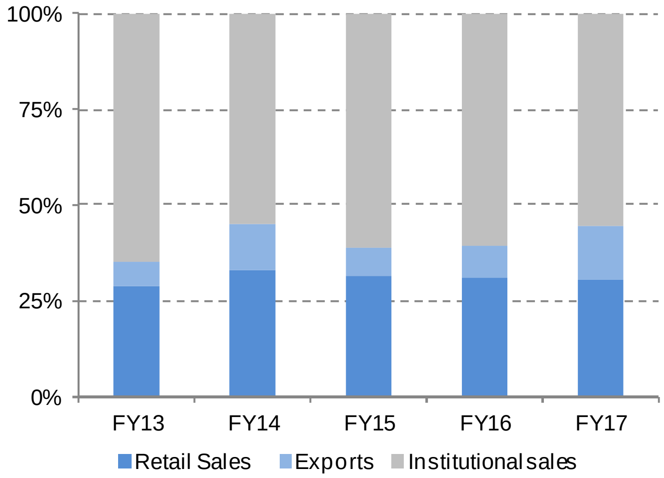
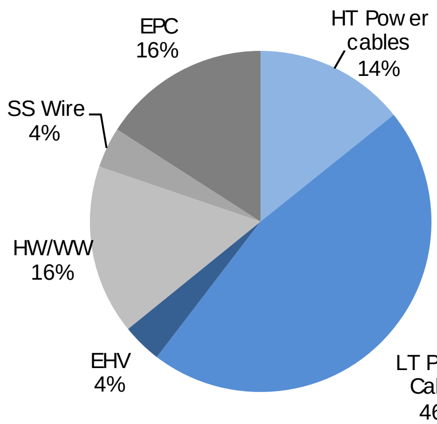


Exhibit 43: Product mix for FY17



Source: Company, SSL

Manufacturing facilities and Capacity

KEII has three manufacturing facilities located at;

1. Bhiwadi (Rajasthan)
2. Chopanki (Rajasthan)
3. Silvassa (Dadra and Nagar Haveli)

In terms of product wise capacity, at the end of FY17 it had installed capacity for;

1. 900 kms of EHV Cables
2. 7500 kms of HT Cables
3. 84000 kms of LT Cables
4. 3600 Kms of Rubber Cable
5. 677000 km of Winding, Flexibles & House Wires
6. 6000 MT of Stainless Steel Wire

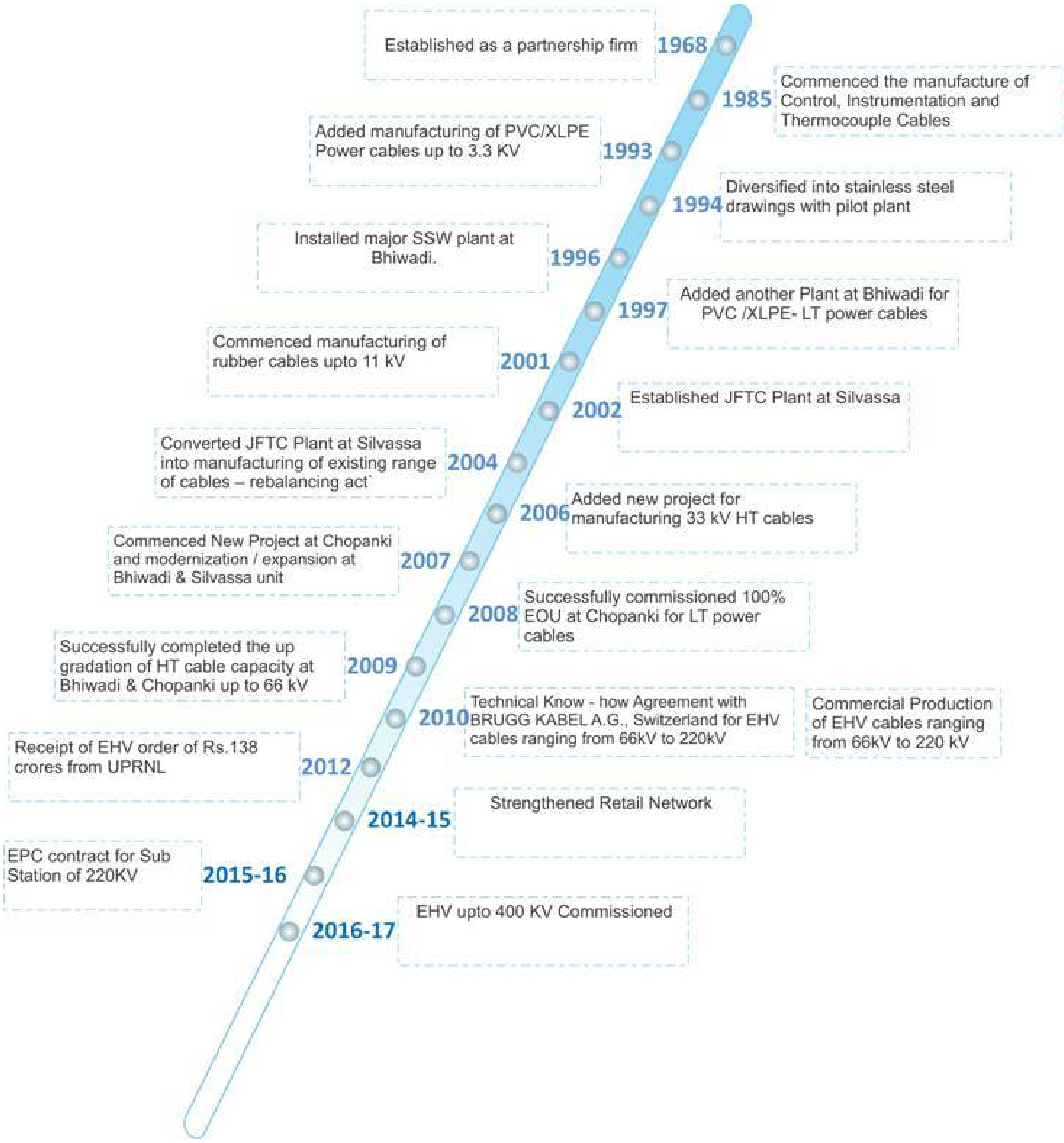
Capacity ramp up over time

During the last decade, KEII has increased its installed capacity significantly.

1. Installed capacity of cables (including LT, HT, EHV, Rubber) has increased to ~3x- from 32,000km in FY06 to 96,000km currently.
2. Installed capacity of winding, flexible & house wire has increased to ~7x – from 100,000km to 677,000km.

Milestones

Exhibit 44: Key milestones



Source: Company, SSL

Valuation and Risks

Valuation

KEI currently trades at 18.4x FY18e and 14.4x FY18e and FY19e EPS. We have assigned a PE multiple of 18x for the stock, based on the weighted average PE of various segments. With PAT CAGR of ~29% over FY17-FY19e and RoE of ~24-25%, we believe the stock will further re-rate. Our TP stands at Rs381 and provides ~25% upside from current levels.

To arrive at the exit PE multiple, we have used the weighted average multiple, as we believe the company's focus on the retail business should command a higher valuation. Over the medium term, we expect the proportion of the retail, institutional and EPC segments to be in the 40%/40%/20% range. We have assigned a PE of 20x to KEI's retail business, as we envisage medium-term growth of ~15% with good margins in this segment. Peers like Finolex cables is trading at ~21x FY19e EPS. The institutional (cable) and EPC segments have been assigned a PE of 18x/15x respectively.

Exhibit 45: Valuation Summary

Valuation	Proportion	PE (x)	
Cable - Retail	40%	20	8
Cable - Institutional	40%	18	7
EPC	20%	15	3
Implied PE (X)			18

Source: SSLe

Risks

Commodity risk: Copper and Aluminium are key raw materials in the cable business. Any large swings in the price of these commodities can pose risk to earnings.

Unorganised market risk: The domestic wires segment has a large portion of unorganised players, who are able to offer products at low prices mainly because they use poor quality material. If prices of raw material remain high, the pricing differential between good and poor quality wires would widen, thereby impacting sales.

Working capital risk: KEII has entered the EPC business in the last few years. Any elongation in the working capital cycle in these contracts can increase the need for working capital, and hence debt levels.

Right of Way: Underground cabling has right of way issues, which can delay the projects, thereby affecting earnings.

KEII is dependent on government schemes like IPDS, DDUJY among others, and hence, any delay in ordering activity can impact the company's business.

Key Management Profile

Exhibit 46: Key Management Profile

Name	Designation	Brief Profile
Mr Anil Gupta	Chairman & Managing Director	Mr. Anil Gupta is a recognized and an accomplished expert in the Indian cable and wire industry with almost 36 years of experience at the helm of KEI
Mrs Archana Gupta	Non Executive Director	Mrs. Gupta has played a pivotal role in transforming Stainless steel wires division
Mr. K.G. Somani	Non Executive & Independent Director	Mr. K.G. Somani is a fellow member of the Institute of Chartered Accountants of India. Mr. Somani is a practicing Chartered Accountant and is also the former president of The Institute of Chartered Accountants of India. Mr. Somani has been on the Board of Directors of many other Private/Public companies.
Mr. Pawan Bholusaria	Non Executive & Independent Director	Mr. Pawan Bholusaria is a fellow Member of The Institute of Chartered Accountants of India. Mr. Bholusaria is a practicing Chartered Accountant.
Mr. Vijay Bhushan	Non Executive & Independent Director	Mr. Vikram Bhartia is a B. Tech (Hons) from IIT Kharagpur and has 31 years of experience in the Engineering Industry.
Mr. Rajeev Gupta	Executive Director (Finance) & CFO	Mr. Rajeev Gupta is B.Com. (Hons.) and a Chartered Accountant. Mr. Gupta has about 24 years experience in Corporate Finance and is presently heading the Finance & Accounts Department of KEI Industries Limited.
Mr. Akshit Diviaj Gupta	Director	Mr. Akshit Diviaj Gupta is a young and dynamic professional with a strong entrepreneurial background. He has got personality with diversifed business interests with BBA degree in Management and Honorary Graduate Fellowship.

Source: Company, SSL

Financials

Income Statement

Y/E Dec (Rs mn)	FY15	FY16	FY17	FY18e	FY19e
Net sales	**20,310**	**23,256**	**26,691**	**31,881**	**37,330**
growth (%)	*25.5*	*14.5*	*14.8*	*19.4*	*17.1*
Operating expenses	18,381	20,833	23,948	28,562	33,385
EBITDA	**1,929**	**2,423**	**2,743**	**3,318**	**3,945**
growth (%)	*26.0*	*25.6*	*13.2*	*21.0*	*18.9*
Depreciation & amortisation	246	253	280	292	309
EBIT	**1,683**	**2,170**	**2,463**	**3,026**	**3,636**
Other income	24	53	104	80	100
Interest paid	1,204	1,270	1,229	1,263	1,387
Exceptional items	26	0	0	0	0
PBT	**529**	**953**	**1,338**	**1,843**	**2,349**
Tax	186	331	351	553	705
Effective tax rate (%)	*35.2*	*34.8*	*26.3*	*30.0*	*30.0*
Net profit	**343**	**622**	**986**	**1,290**	**1,645**
Minority interest	0.0	0.0	0.0	0.0	0.0
Reported Net profit	**343**	**622**	**986**	**1,290**	**1,645**
Non-recurring items	17	0	0	0	0
Adjusted Net profit	**326**	**622**	**986**	**1,290**	**1,645**
growth (%)	*180.7*	*91.0*	*58.6*	*30.8*	*27.5*

Balance Sheet

Y/E Dec (Rs mn)	FY15	FY16	FY17	FY18e	FY19e
Cash & Bank balances	**47**	**58**	**370**	**698**	**371**
Other Current assets	10,266	10,746	13,576	15,114	17,604
Investments	31	31	31	31	31
Net fixed assets	2,971	3,262	4,027	4,235	4,126
Goodwill & intangible assets	10	17	27	27	27
Other non-current assets	92	516	79	88	1,588
Total assets	**13,417**	**14,629**	**18,110**	**20,193**	**23,748**
Current liabilities	6,353	6,189	6,358	7,317	8,303
Borrowings	3,758	4,371	6,540	6,439	7,439
Other non-current liabilities	267	402	478	478	478
Total liabilities	**10,379**	**10,963**	**13,375**	**14,234**	**16,220**
Share capital	154	154	156	156	156
Reserves & surplus	2,884	3,512	4,579	5,803	7,373
Shareholders' funds	**3,039**	**3,666**	**4,735**	**5,959**	**7,529**
Minority interest	0	0	0	0	0
Total equity & liabilities	**13,417**	**14,629**	**18,110**	**20,193**	**23,748**

Key Financials ratios

Y/E Dec	FY15	FY16	FY17	FY18e	FY19e
Profitability and return ratios (%)					
EBITDAM	9.5	10.4	10.3	10.4	10.6
EBITM	8.3	9.3	9.2	9.5	9.7
NPM	1.6	2.7	3.7	4.0	4.4
RoE	11.3	18.6	23.5	24.1	24.4
RoCE	15.3	18.7	18.7	17.7	18.5
RoIC	4.5	8.1	10.0	10.9	12.1
Per share data (Rs)					
O/s shares (mn)	77.2	77.2	77.8	77.8	77.8
EPS	4.2	8.1	12.7	16.6	21.1
FDEPS	4.2	8.1	12.7	16.6	21.1
CEPS	7.4	11.3	16.3	20.3	25.1
BV	39.3	47.5	60.9	76.6	96.8
DPS	0.0	0.5	0.6	0.7	0.8
Valuation ratios (x)					
P/E	72.3	37.9	24.1	18.4	14.4
P/BV	7.8	6.4	5.0	4.0	3.2
EV/EBITDA	14.1	11.5	10.9	8.9	7.8
EV/Sales	1.3	1.2	1.1	0.9	0.8
Other key ratios					
D/E (x)	1.2	1.2	1.4	1.1	1.0
DSO (days)	82	82	89	87	83
Du Pont Analysis - RoE					
NPM (%)	1.6	2.7	3.7	4.0	4.4
Asset turnover (x)	1.6	1.7	1.6	1.7	1.7
Equity multiplier(x)	4.5	4.2	3.9	3.6	3.3
RoE (%)	11.3	18.6	23.5	24.1	24.4

Source: Company, SSLe

Cash Flow Statement

Y/E Dec (Rs mn)	FY15	FY16	FY17	FY18e	FY19e
Pre-tax profit	529	953	1,338	1,843	2,349
Depreciation	246	253	280	292	309
Chg in working capital	47	(509)	(2,588)	(588)	(1,505)
Total tax paid	(92)	(196)	(304)	(553)	(705)
Other operating activities	1,250	1,350	1,313	1,263	1,387
Operating CF	**1,979**	**1,852**	**38**	**2,257**	**1,835**
Capital expenditure	(167)	(975)	(617)	(500)	(1,700)
Chg in investments	0	0	-	-	-
Other investing activities	0	0	0	-	-
Investing CF	**(166)**	**(975)**	**(617)**	**(500)**	**(1,700)**
FCF	**1,813**	**877**	**(579)**	**1,757**	**135**
Equity raised/(repaid)	5	-	20	-	-
Debt raised/(repaid)	(559)	387	1,871	(100)	1,000
Dividend (incl. tax)	(18)	(37)	(46)	(66)	(75)
Other financing activities	(1,239)	(1,215)	(953)	(1,263)	(1,387)
Financing CF	**(1,811)**	**(866)**	**891**	**(1,429)**	**(462)**
Net chg in cash & bank bal.	**46**	**47**	**58**	**370**	**698**
Closing cash & bank bal	**47**	**58**	**370**	**698**	**371**

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Currency Derivatives: INE 231052938 | CDSL: IN-DP-CDSL-370-2006 | IRDA/IR2/2014/241

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Guide to the expected return over the next 12 months. 1=BUY (expected to give absolute returns of 15 or more percentage points); 2=HOLD (expected to give absolute returns between -10 and 15 percentage points); 3=SELL (expected to give absolute returns less then -10 percentage points)

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